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Co-op CU Growth Outlook: Bridging member needs and payments strategy to deepen trust

A Co-op Solutions research study in partnership with EY and Filene Research Institute

Inside

Executive summary

What credit unions need to know

Credit unions face a daunting set of challenges in maintaining and growing their member relationships, as well as enhancing their ability to reach a new generation of financial consumers. Changing consumer expectations, accelerated in many cases by the COVID pandemic, are moving toward digital banking primacy, reducing the need for in-person, face-to-face interactions in a physical branch. At the same time, disruptive and agile competitors are eating into credit unions' market share in traditional financial services areas such as banking, investing and lending, with increasing levels of success.

To better understand the current marketplace, Co-op Solutions partnered with global consulting firm EY (formerly Ernst & Young) to determine how financial consumer and member behaviors, preferences, challenges and activities have changed over the past year. For an added layer of insight, Co-op also engaged Filene Research Institute to assess credit unions' current challenges and opportunities for growth.

Key findings include:

- Fintechs are harnessing payment products to accelerate growth and take over the marketplace. For example, *PayPal experienced 5X relative growth in PFR and Chime showed 18X growth.*
- *Consumers trust fintechs over credit unions to serve their digital payment needs and wants, with credit union primary payment relationships falling by 3%.*
- 66% of consumers use some form of digital payments, *yet only 16% report doing so directly with their credit union.*
- *41% of respondents* would consider leaving a credit union because the products don't meet their current needs.
- *78% of respondents* don't expect their credit union to offer the digital payment options right for them.
- *Delivering the right products and services to meet daily needs now rivals data protection, security and personal relationship as the most important factor when trusting a financial institution.*

To address these evolving expectations and increased competition, and be truly member-centric, *credit unions must support their members in their daily activities*, interacting with members at multiple points each day. The best way to activate daily engagement is by offering digital payment options, while *creating financial transparency and helping members take control of their own financial lives.*

There is ample opportunity for credit unions to "future proof" their economic and service models. With the support of strategic industry partners with the expertise and ability to provide consultative advice and the right solution set, credit unions can design a modern member experience that will help them grow and maintain their member base while increasing operational efficiencies to propel credit union growth.

Part 1: 2022 Outlook

Consumers don't trust their credit union to meet their digital payments needs

When it comes to meeting their digital financial needs, consumers trust fintechs more than they trust credit unions, based on an emerging, new definition of what trust means for today's financial consumer. This is the headline takeaway from Co-op's latest in-depth research on the credit union movement, *which suggests that consumers don't trust that credit unions are able to offer the digital payment solutions they need and want*.

Credit unions' and financial consumers' priorities are not fully aligned. The opportunity for credit unions lies in addressing this gap between credit union strategy and member expectations to ensure the industry continues to grow and meet the needs of the market well into the future.

Members expect (and deserve) meaningful interactions that enable their financial well-being. But for credit unions to have success in providing these meaningful interactions and member-focused solutions, they must understand what the modern financial consumer wants and needs during a time of revolutionary change in financial services.

With consumers now curating their own personal financial ecosystem through various apps, credit unions need to reexamine what it means to serve the evolving needs of today's financial consumer. Being member-centric means meeting them where they are: providing convenient, always-available digital payment solutions, offering compelling, rich loyalty rewards, and proactively anticipating their needs.

Yet credit unions can't do this alone. During such a pivotal time, the spirit of cooperation inherent in the word "cooperative" has never been more important.

In looking at both the member and credit union perspectives, it becomes clear there is a gap between credit unions' current priorities and product offerings, and the solutions that the broad market of current and prospective members say they need today.

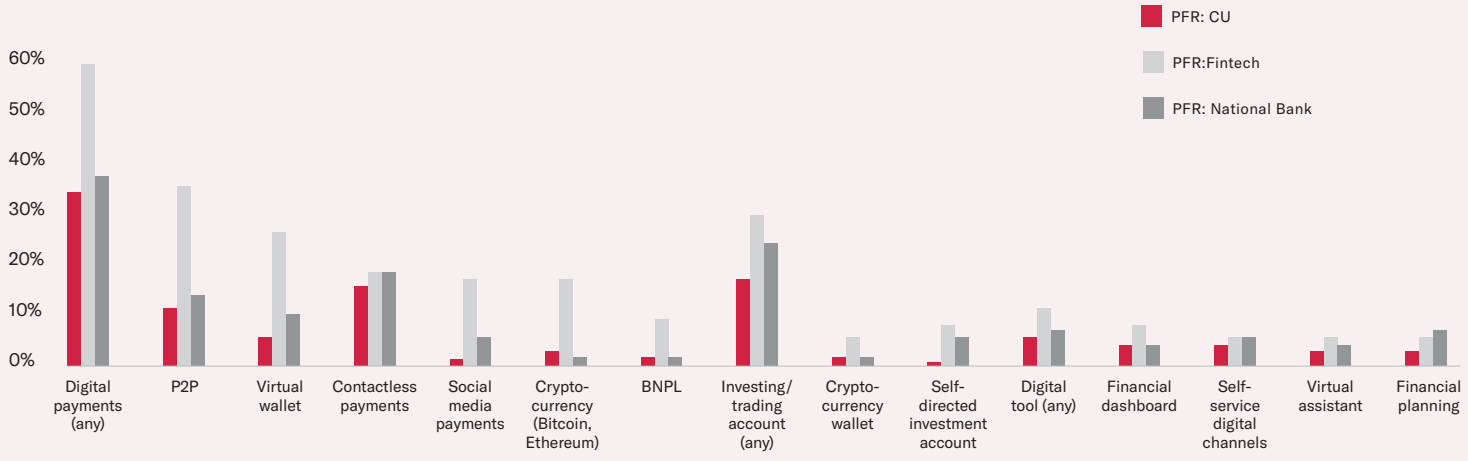
Fintechs are winning on digital engagement and payments

In 2021, consumers reported wanting digital engagement. And in 2022, fintechs made it happen.

The 2021 CU *PaymentsOutlook* from Co-op revealed several key and concerning trends. Respondents largely had fragmented relationships with their financial services providers and typically evaluated multiple financial institutions to meet their varied needs.

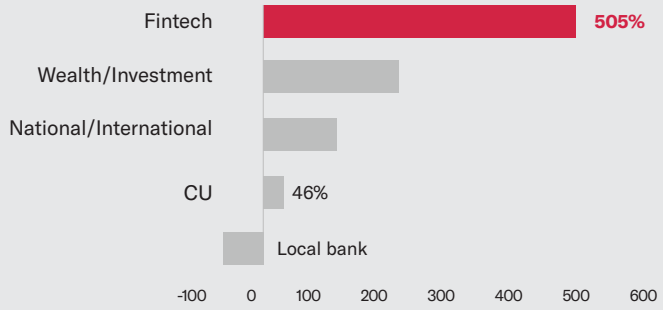
In addition, consumers were becoming more digitally engaged, and growing more comfortable interacting with financial providers via the digital channel.

Fintechs are taking over the market by harnessing payments products



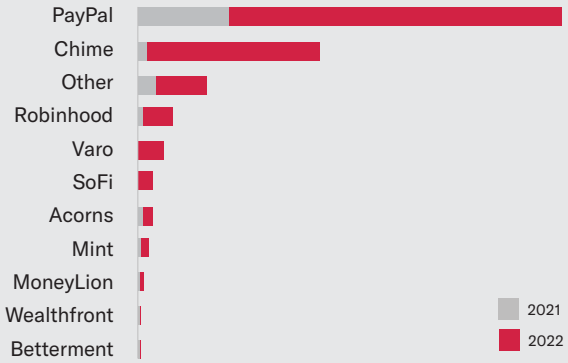
2022

Fintechs are growing faster than all other institutions



The growth of Fintechs, national banks and wealth managers has far outpaced that of CUs

Respondent primary financial relationships from 2021 to 2022



YoY, PayPal has experienced 5X growth, Chime has experienced 18X, Robinhood and Mint have both experienced 4X growth

Lastly, in 2021 we saw that comprehensive digital ecosystems — in the form of rapidly growing and diversifying financial technology firms like PayPal, Chime, Robinhood and Mint — were fast becoming the major competitors to credit unions, surpassing regional and national banks as the biggest threat to cooperatives.

In 2022, these trends have not only continued, but accelerated. Moreover, fintechs are doubling down on their takeover of the financial services market with an increased focus on placing payments at the center of all they do.

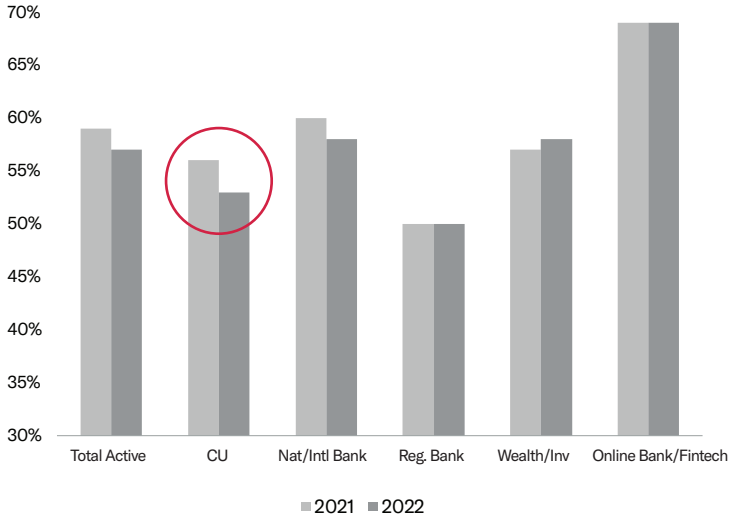
Fintechs are growing rapidly — faster than all other types of financial institutions — and are capturing primary financial relationship status from credit unions. For example, between 2021 and 2022, *PayPal experienced 5X relative growth in PFR, Chime showed 18X growth, and both Robinhood and Mint quadrupled the number of respondents that identified them as their PFR*.

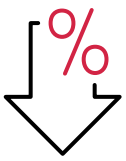
Consumers want providers to deliver the right services to meet their daily needs

Why are financial consumers leaving their traditional relationships with credit unions and banks for these new, upstart competitors? It's largely a matter of trust. Specifically, consumers trust fintechs more than credit unions when it comes to serving their digital payment needs and wants.

In fact, credit unions were the only primary financial relationship type to show statistically significant declines in the past year. Credit unions' primary payments relationships fell by 3%, while other providers, including national and international banks, regional banks, wealth and investment firms, and online banks and fintechs, either remained flat or showed growth.

Primary payments relationships





-3%

Credit unions had statistically significant declines

Credit unions are the only PFR type with significant declines over the last year.

Delivering the right products and services to meet daily needs rivals data protection, security and personal relationship — which credit unions do very well — as the most important factor when trusting a financial institution. Consider that:

- 41% of respondents would consider leaving a credit union because the products do not meet their current needs.
- 78% of respondents don't expect their credit union to offer the digital payment options that are right for them.
- When it comes to products and trusting your PFR, credit unions scored 5 points below the average for all financial institutions. Meanwhile, national banks led in engagement with prospects.

For credit unions, which have long enjoyed high levels of trust with their members, the time has come to redefine what trust means.

To put it another way – *credit unions need to reexamine what it now means to be member-centric.*

Member satisfaction with credit unions is declining

This trust factor is bleeding into member satisfaction, as well.

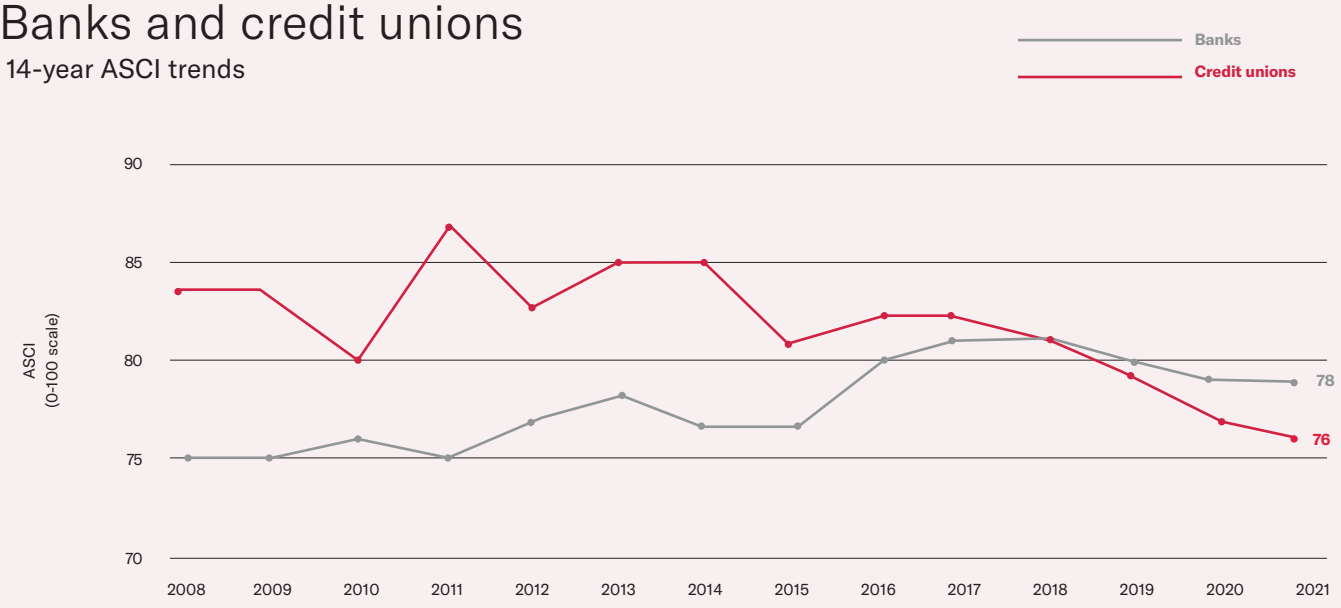
In 2021, credit unions fell behind banks in consumer satisfaction for the third year in a row. And the gap is widening.

The pressures of digital transformation and a changing competitive landscape are shaking financial services — and the traditional banking model — to its core.

Banking has been transformed by high levels of product commoditization. The ability for credit unions and community banks to provide highly personalized, one-to-one service is becoming increasingly difficult as digital channels become the primary mode of interaction. The result is that the banking relationship has become increasingly transactional and fragmented, leading to an erosion of consumer loyalty to traditional financial institutions.

Banks and credit unions

14-year ASCI trends



In 2021, credit unions fell behind banks in consumer satisfaction for the third year in a row.

Credit union focus: What's on your minds?

Earnings: Evolve the mix

Diversify lending products and lend more deeply to members – pre-approvals, alternative credit data, new acquisition channels

Then, grow non-interest income through payments revenue

Experience: Deepen member engagements

Deliver seamless omnichannel delivery for member satisfaction and new member attraction

Expenses: Manage infrastructure transformation

Data: Leverage transaction and other forms of data to understand member needs

Tech Stack: Integrate tools and technology to enable omnichannel delivery to consumers

Decision making: Capacity is limited

Advise and help prioritize roadmaps and provide a nimble architecture for future transformation

Credit union leaders confront multiple pressure points

Today's credit union leaders are confronted on all sides by immense pressures on the traditional CU business model. These challenges can be categorized under the "3 Es" — *Earnings*, *Experience* and *Expenses*.

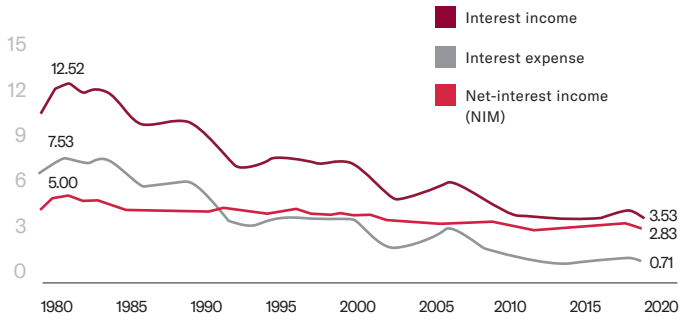
Earnings

Over the past several decades, margin compression has diminished interest returns. As an industry, interest income per average assets declined to roughly 3% in 2021 — down 96 basis points from the prior two years. But this is part of a long-term trend resulting from an extended low-rate environment. While the Federal Reserve has recently begun to raise rates to combat inflation in 2022, from a historical perspective, net-interest margin alone may never again drive systemic growth.

For this reason, non-interest income has become increasingly important to credit union revenues over the past several decades. Yet, credit unions have become over reliant on overdraft protection (ODP) and other sources of fee income, which are now receiving increased attention from the Consumer Financial Protection Bureau (CFPB)[i], NCUA and Congress[ii].

Financial services is undergoing a fee evolution as many providers — prodded by early moves by digital neobanks and larger commercial banks and seeking to get ahead of the regulatory curve — look to reduce or eliminate overdraft, ATM and other fees. This threatens a source of income for many, especially small and mid-sized financial institutions. Credit unions could be disproportionately impacted, as many fall into smaller asset-size peer groups and are unable to rely on income from investment trading and other business lines.

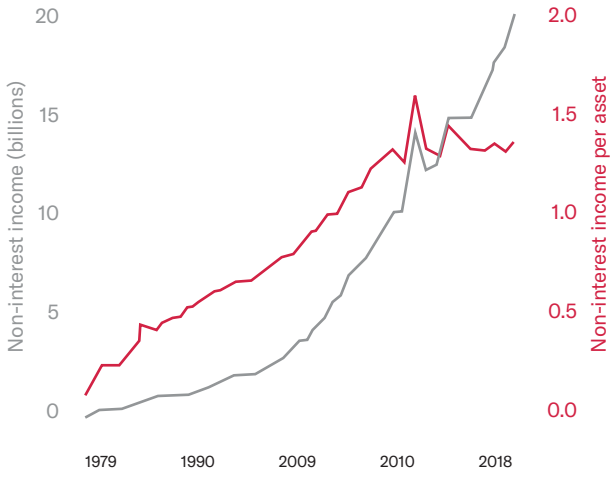
Declining net-interest margins narrow opportunities to drive growth through lending



[i] "CFPB Launches Initiative to Save Americans Billions in Junk Fees," Consumer Finance Protection Bureau, January 26, 2022. https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-launches-initiative-to-save-americans-billions-in-junk-fees/

[ii] "Is the United States Over Overdraft Fees?" The Regulatory Review, January 22, 2022. https://www.theregreview.org/2022/01/22/saturday-seminar-united-states-over-overdraft-fees/

Non-interest income & non-interest income per asset



Non-interest income has become crucial to financial institutions' balance sheets.

But fees (overdraft, NSF, ATM, etc.) are facing growing regulatory attention, consumer backlash, and market competition, especially from digital neobanks.

Experience

Credit union leaders are also feeling the pressure of meeting the changing expectations of financial consumers through an evolving set of new delivery channels. This challenge is compounded by increasing competition from new, digitally native market entrants, driving the entire industry toward increased product commoditization. Whereas credit unions in the past have been able to rise above the fray by offering outstanding member service and a personalized touch, this commoditization coupled with the everything/anytime/anywhere demands of today's consumer is making it difficult to differentiate.

Today's credit unions must focus on delivering seamless, omnichannel experiences in order to increase member satisfaction, retain and grow existing primary financial relationships, and attract new financial consumers to the "Credit Union Difference."

Expenses

While traditional interest-based revenue streams are stagnating, margins are becoming slimmer, and even non-interest income is under threat from increased regulatory oversight, fixed and variable costs of overhead, technology and wages continue to increase, driving down profitability.

Credit unions must manage their infrastructure transformation carefully to keep expense ratios low during this period of disruption. This means gaining the ability to access and fully leverage transactional and other forms of data to better understand the needs and desires of their members.

Credit unions must also reimagine their tech stack for a new era, by integrating tools and technology to enable convenient, anytime/anywhere, omnichannel digital delivery of services to their members.

To address these formidable challenges, credit union leaders are seeking to build on the industry's long-standing strengths — i.e., the "Credit Union Difference" — to jumpstart new momentum for innovation and growth.

Part 2: A member-centric roadmap for credit union success

Build on core strengths to drive growth

Rather than reinvent the wheel or compete with new entrants on their terms, credit union leaders are looking to build on their organizations' — and the credit union system's — established strengths and differentiators. These include credit unions' local presence, people-first philosophy and ability to adapt quickly to market changes.

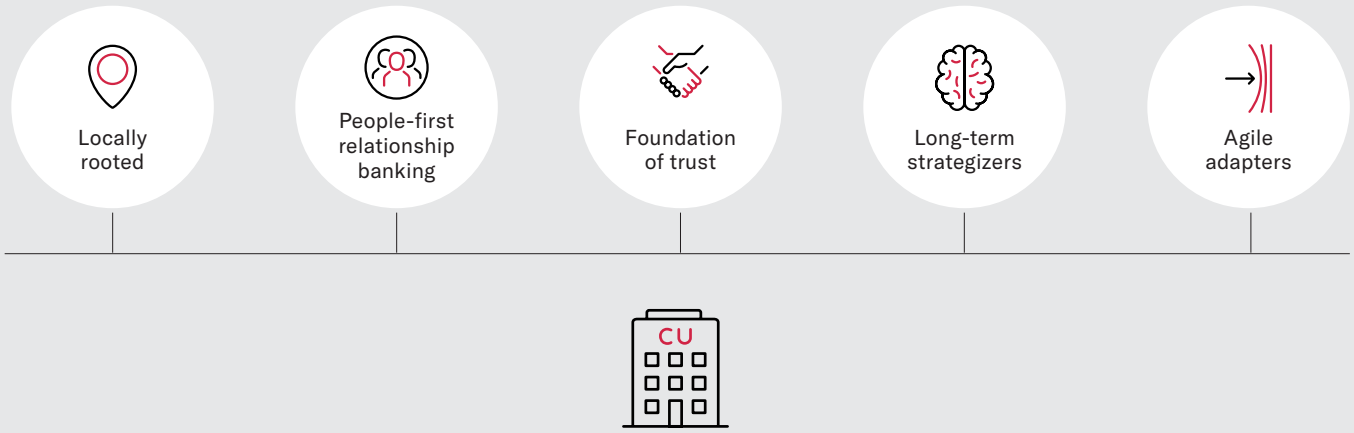
Credit unions' original field-of-membership frameworks offer a starting point to build a clear strategic focus around members' changing life needs. Originally, most cooperatives were established to serve the employees of one or multiple select employee groups (SEGs), or the members of unique associational groups.

These close-knit fields of membership helped establish tight, natural bonds among credit union members, and between the members and "their" credit union.

Today, after many credit unions have expanded their fields of membership through community charters and other means, they need to identify new ways to be member-centric. The "people-first" philosophy is being manifest in the form of financial well-being and community social impact strategies.

At the same time, credit union leaders are actively seeking change. While credit unions are often said to be conservative and risk-averse institutions, numerous credit union leaders are ready to embrace new ideas and innovative solutions. Many credit unions displayed profound agility in adapting to the pandemic, and many found that as smaller organizations, they felt less inertia in existing processes and discovered a previously unacknowledged capability and willingness to pivot quickly and reset strategy.

For example, American 1 Credit Union ($493.2M, Jackson, MI) implemented its "Entrepreneurial Operating System" during the pandemic, allowing leadership to practice agility and make quicker decisions about people, strategy, systems and processes. Similarly, Element Federal Credit Union ($52.2M, Charleston, WV) credited its employees' and leadership's ability to act quickly and decisively at the onset of COVID as it shifted to working remotely and discovered new ways of serving its members[iii].

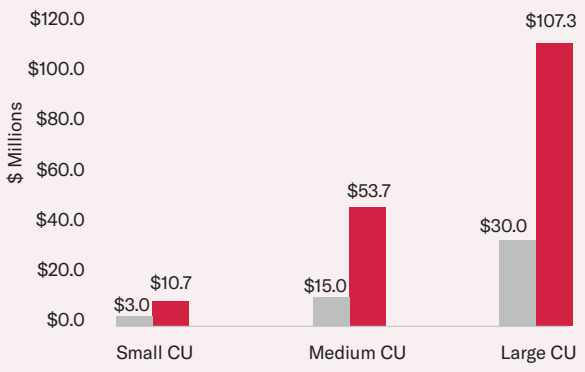


Credit union leaders are seeking to build on long-standing strengths to find new momentum.

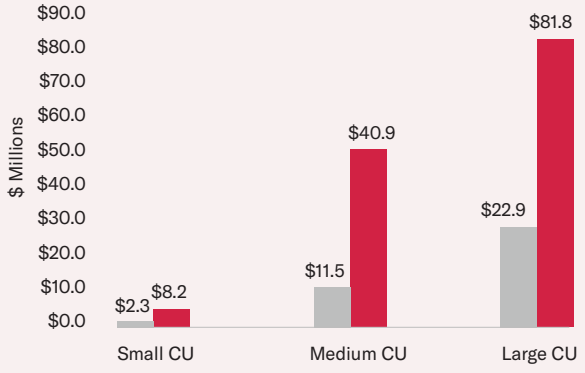
[iii] "Lessons Learned from a Challenging Year (Part 2)," by Marc Rapport, Callahan & Associates https://www.creditunions.com/articles/lessons-learned-from-a-challenging-year-part-2/

In addition to organic growth, the total addressable market reveals that a comprehensive payments-focused strategy can drive significant incremental loan and deposit growth.

Incremental deposit growth



Incremental loan growth



Conservative target

Bold target

CU asset tiers:
Small CU – $1000
Medium CU – $100-$500M
Large CU – $500M-$1B

Average of ~$12,000 in deposit and ~$9,500 in loans per credit union member
Source: National Credit Union Administration Quarterly Data Summary Q3 2021

Bridge the gap through payments

To overcome this gap, credit unions are already committing to substantial investments in technology in the form of digital and mobile banking, member onboarding and loan origination systems; data aggregation, systems integration and business intelligence technology; new value propositions to address consumers' desire for financial wellness solutions as well as for the companies they do business with to have a positive social impact; and talent acquisition and retention through higher wages and more specialized expertise up and down the org chart.

These strategic investments are critically important both for the individual credit unions and for the future of the movement. But the common element that must be addressed is that credit unions have to support their members in their daily activities. And the number one way to achieve this is through payments.

> Our goal far out is that payments will not necessarily be a source of revenue itself. [...] Other companies will do payments for less or for free. Instead, we will monetize the transactional data. [...] Maybe we don't need interchange and we don't need fees, because when someone joins, they bring enough with them that we understand what they need.
>
> *Chief Experience Officer, $1B credit union*

> I want more robust data. Then I can really segment the market [...] to make sure we are getting penetration in all parts of the market and then ultimately personalization. That's the end goal.
>
> *Vice President, $3B credit union*

Credit union competitors are leveraging payments to gain daily relevance and increase wallet share. In fact, *34% of respondents report looking outside their current financial relationships* for products that meet their needs. And 44% of consumers would start a new relationship for a *superior product value proposition*. In fact, respondents *who use a digital payment product indicated they would increase the number of products they use by 60%*.

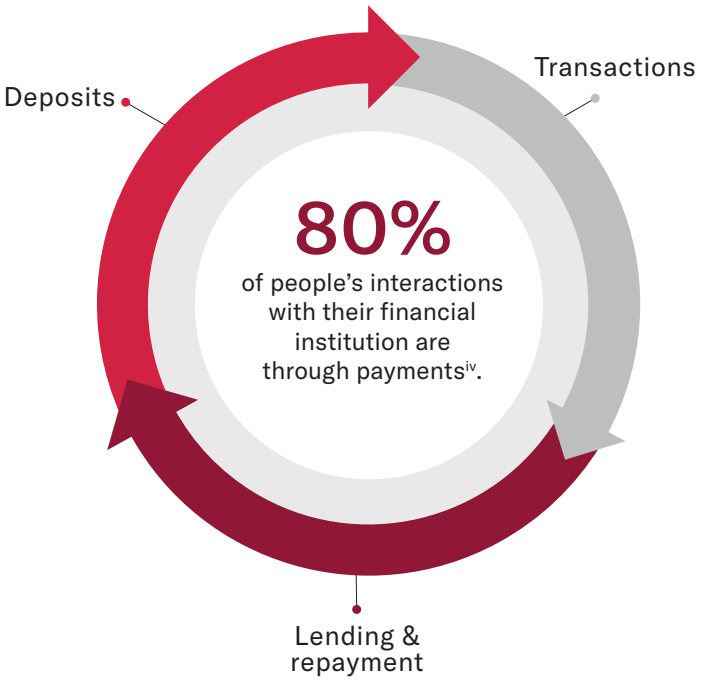
According to Accenture, 80% of people's interactions with their financial institution are through payments[iv]. Payments represent the hub around which all other financial activities orbit — including deposits, transactions and lending. By adopting a payments-focused strategy, credit unions can drive significant incremental loan and deposit growth.

Not only that, payments represent the single most productive source of the transactional data needed for comprehensive member behavioral analysis. The credit union executives surveyed desire increased access to transactional data to help them make better decisions and segment their market more effectively. Payments represent the best — and perhaps only — way to obtain a real-time, detailed look at members' behavior: how they spend, where they spend their time, and what their priorities are.

Credit union leaders also have deep concerns with rising expenses. They recognize the need to invest in foundational infrastructure to meet the evolving needs of the market and their members. But they also desire simplicity in strategy and planning, investments and resource allocation, through partnerships that are truly relationship-focused and mutually beneficial.

Credit union leaders are calling for a new value proposition and business model.

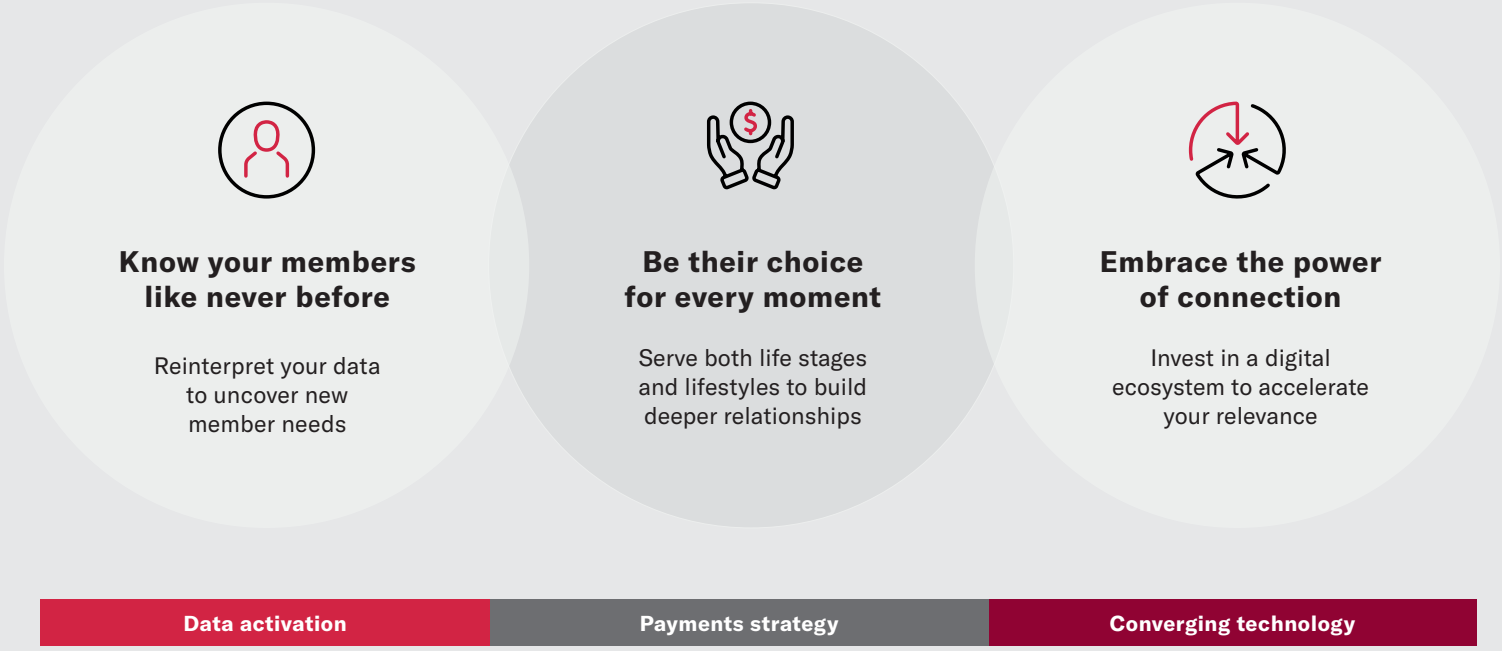
Support members in their everyday financial activities



> We feel like we have to stop being all things to all people. For decades [we've said that] we're the cheap, low-cost provider of everything you want. Our vision document will change. What can we try that will be completely different?
>
> *EVP & Chief Strategy Officer, $1B credit union*

[iv] Accenture, "Five Big Bets for Retail Payments in North America" (2019)

The new member-centricity: 3 keys to gaining active primary financial relationships



Know your members like never before

Traditional banking presumes increased financial needs and complexity over time. However, this approach no longer meets members' needs, as evidenced by the fact that *less than 50% of young people own the financial products they need to be fully prepared for a life event,* and that, on average, *consumers own five banking relationships across different financial institutions*.

To combat this, credit unions should pursue a multi-dimensional segmentation strategy that considers traditional, demographic-based market segmentation (e.g., gender, age, wealth tier, marital status, geography), coupled with a needs-based segmentation that incorporates life events, lifestyles and a mix of solutions that address both.

The key lies in activating a strategy of *Lifestyle Enablement* — creating active, daily engagement with your members aimed at serving their financial well-being.

Some leading fintechs have already achieved market-leading growth through this approach. Chime has effectively broken down its segmentation strategy to a "customer of one." They have accomplished this by incorporating AI and analyzing non-standard, alternative data points to develop a fuller, more complex picture of their target customer[v].

To catch up, credit unions must evolve from a product-centric to a member-centric design approach and begin offering personalized lifestyle services to their members. According to the 2021 CU *PaymentsOutlook* research by Co-op, by adjusting their product mix to offer desirable lifestyle banking features, credit unions can retain, capture and recapture PFRs across a broad swath of current and prospective members by offering a mix of "high valued" and "standard" features.

[v] "How Chime is Dominating Digital Banking (And All of Banking)," by Ron Shevlin, Forbes, November 16, 2020. https://www.forbes.com/sites/ronshevlin/2020/11/16/how-14-billion-chime-is-dominating-digital-banking-and-all-of-banking/?sh=1d6efaf42210

There were 18 top use cases that came out of the 2021 research. If a credit union can offer the first *eight "basic" feature offerings* — including in-person access to a banker or financial planner, ID theft and fraud detection and protection, and offering relevant products, content and insights at the right time — this will get them to parity and loyalty with their members in the market. This helps the member understand their financial position.

The second set of 10 out of the 18 is designed to help members take actions to improve their financial lives. These are the 10 *"most impactful" features* for credit union members and prospects that will help them establish relationship primacy. These enhanced features included control over personal data, virtual access to a financial planner, relationship pricing discounts, up to $10,000 in instant funding and the ability to receive paychecks two days early.

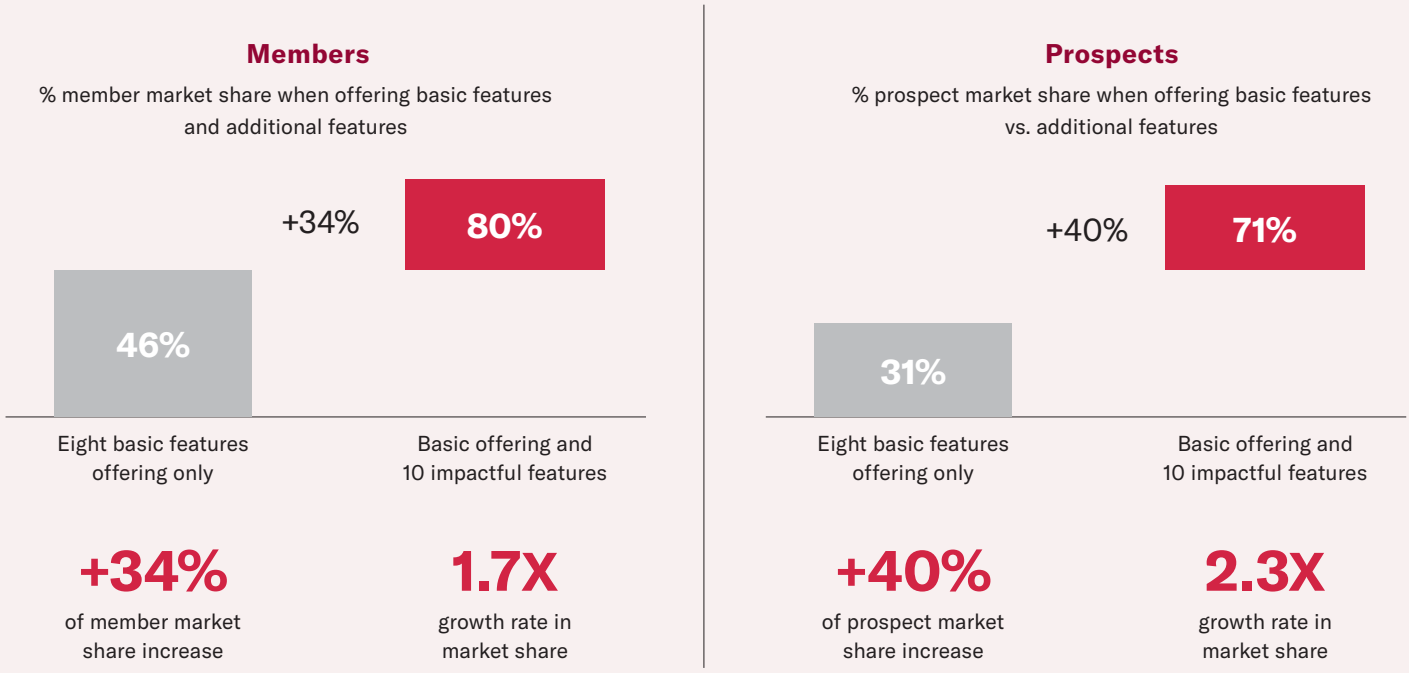
When credit unions offer both the "table stakes" basic features plus additional impactful features for little or no cost, they can achieve increases of *34% in member market share, and 40% among prospects*.

Be their choice for every moment

As discussed above, consumers have bifurcated their PFRs between a primary savings institution (read: "passive") and a primary transactional interface (read: "active"). Whereas credit unions are in a strong position with regard to passive relationships (ranked #1 for loans, savings and checking in the 2021 CU *PaymentsOutlook* survey), fintechs have achieved the top slot in active relationships (and credit unions fall to #3). *Payment products like contactless, P2P and mobile wallets drive more engagement, and form the heart of these active, transactional relationships*.

The reasons are that users of payment products stay in the offering firm's ecosystem, engage with the provider's other products and services, and actively use social media to share their stories and experiences. Members should not be expected to have to leave the credit union's ecosystem to meet all their financial needs, including payments, mortgage and loan applications, wealth advisory services, insurance and personal financial management, to name a few. To maintain PFR status, the credit union must establish itself as the hub of their members' entire financial lives.

Creating active, daily engagement aimed at financial well-being captures market shares



This is evidenced by the percentage of members in the survey, across a range of needs-based segments, that consider their credit union as their PFR provider. Although credit unions ranked highly in certain demographic segments such as Gen Z and Baby Boomers, Fintechs have become popular PFR across all age groups (particularly 18-44). Banks also figured strongly into the mix, as most prospects across all age groups consider a local or national bank as their PFR.

Among credit union members, credit unions are still a popular choice as PFR, especially for people who are in financial trouble or ready to retire; however, fintechs lead among several segments, including career starters, young family, and those looking to get ahead. Prospective credit union members mainly consider local and national banks and fintechs as their PFR. Moreover, *fintechs are overwhelmingly consumers' most popular PFR choice to meet their life event, lifestyle and solution mix needs*.

Today's credit unions don't only compete against other FIs, but also with well-respected Big Tech firms like Amazon, Netflix and Apple. Consumers expect and demand the same convenient, 24/7 experience they receive from these household names, and they have little patience to wait for their financial institutions to catch up.

The pathway to PFR goes through digital payments.

Embrace the power of connection

Fintechs have risen to relationship primacy over the past few years largely through the deployment of innovative digital technology and solutions. The pathway to primacy for credit unions will require accelerating their investment in digital capabilities and bridging the gap between their digital and non-digital channels, which will enable them to *deliver financial well-being through digital tools*.

Consumer behavior and desires are trending toward digital tools that improve financial well-being. Daily movement and management of money behaviors lead consumer preferences and reinforce the need for active relationships with members.

One-third of respondents, especially younger demographics, *report needing any form of digital payment to be prepared for relevant life events*. All respondents ranked spending behaviors, viewing personal trends and cross management of payment/financial sources as the top insights they are looking to obtain to manage their daily finances.

Furthermore, *if credit unions invest in lifestyle banking product offerings, they can gain significant market share of both members (+16%) and prospects (+13%)* versus the status quo. Conversely, their current lead with members can be lost if they don't invest at all.

Data protection, security and rewards are among the most valuable features for credit union members. Digital interactions are taking lead over non-digital channels, yet non-digital channels have not entirely gone away.

Tools like account reminders, asset aggregators and bill simplification are the leading product desires of all respondents. This means that the very definition of financial wellness has evolved and is now defined as *daily management of finances, in addition to forming long-term goals*.

If credit unions embrace this strategy of placing payments at the center of the relationship, while delivering financial well-being through digital tools, it can *drive 4.9 million in incremental member acquisition opportunity*.

The opportunity for growth for credit unions is there — *if they can bridge the gap between current state offerings and what consumers expect and demand*.

> Among credit union members, credit unions are still a popular choice as PFR, especially for people who are in financial trouble or ready to retire; however, fintechs lead among several segments, including career starters, young family, and those looking to get ahead.

The credit union of tomorrow will have personal relationships at the center, with compelling digital-branch services and products and strong data security and protection protocols built in. Credit unions already hold strong incumbent advantages: They are their members' most highly valued providers, offering outstanding service, trusted advice and secure banking solutions. By introducing market-leading digital technology and services, credit unions are well positioned to offer the broader marketplace a value proposition that would serve as a compelling alternative to the digital-only brands.

With the support of strategic industry partners with the expertise and ability to provide consultative advice and the right solution set, credit unions can design a modern member experience that will help them retain and grow primary financial relationships with their members.

The time to begin this evolution — or revolution — is today.

Survey methodology

In collaboration with Co-op, EY conducted a market research survey of 2,000 current credit union members and 1,000 prospects across all regions of the U.S. to determine their preferred banking behaviors. The survey sample encompassed a diverse mix of demographic groups covering multiple generations, income levels and asset sizes.

Only statistically significant measures were used to derive insights; any inadequate responses were removed.

EY's framework is based on the importance of a holistic approach toward member and prospect experience through the "needs-based segmentation."

In addition, in 2022 Co-op engaged Filene Research Institute to conduct an environmental scan of the credit union system. As part of its research, Filene surveyed credit union leaders on the challenges facing their organizations in 2022 and over the next strategy cycle.

Learn more

To request more information on credit union payments strategies, please contact your Co-op representative, call 800.782.9042 or email solutions@coop.org.

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